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Hoover, Herbert

The problem of prosperity

[New York]

[1922]

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THE PROBLEM OF PROSPERITY

*and the part in it played by the
American Railroads*

Testimony of HERBERT HOOVER, Secretary of Commerce
Before the Interstate Commerce Commission



February 4, 1922

TO MR. W. H. HARRIS

HE 2741

48

Gift The Problem of Prosperity

Statement by the Secretary of Commerce Before
the Interstate Commerce Commission

Gentlemen of the Commission:

I N responding to the invitation to discuss some of the problems present in your general railroad investigation I shall devote myself to three of the railway topics which especially arise from the present economic situation.

I do not need to review at length that we are recovering from the destruction and inflation of the greatest war in history, that we are suffering from the waste, the extravagance and over-expansion of the post-war boom, and that the war has brought about great shifts in the movement and price levels of commodities between nations. I would, however, suggest that it might be profitable for our people to get a somewhat clearer perspective of our own, and the world's troubles and problems.

Even a superficial survey must bring us out of an atmosphere of gloomy introspection into an assuring realization that, great as our dislocations may seem to be, we relatively are in an enviable position. Our nation is unshaken and as a people we are getting our bearings in a world of perplexing economic adjustments.

While there is unemployment and lack of profit taking, we are free of panic. We are comparatively more restless than injured. For instance, as heavy as our tax burden is, it is still less than one half as great in proportion to our nation's productivity as the other states in the war.

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Box 105

THE PROBLEM OF PROSPERITY

The violence of our readjustment, however, is without parallel and we sometimes tend to color our measures for the future by the depression we are in. The fact is that we must predicate all plans for the future on the ultimate return of the American people to a normal economic activity, with our annual progress in the expansion of our production, of our plant and equipment, of our skill and our efficiency.

There can be no question that this return will take place, and no responsible body will approach our problems on any other basis. Not one of us would submit to the charge that we were not prepared to bet against any odds upon the future of the United States. Our problem is to expedite this recovery—to speed up employment of our workers, and thereby find a market for our farmers.

TO MR. J. M. HARRIS
WASHINGTON

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I

Economic Situation of the Nation

IF we look at the national economic situation as a whole, the greatest impulse that can be given to recovery from any source whatever is a reduction of rates on primary commodities combined with the immediate resumption of railway construction and equipment. The first depends upon reduction of operating costs, the second upon restoration of credit for our railways.

One thing is absolute. Our transportation facilities are below the needs of our country, and unless we have a quick resumption of construction, the whole community—agricultural, commercial, and industrial—will be gasping from a strangulation caused by insufficient transportation the moment that our business activities resume.

For the past five years we have had no consequential expansion to our railway transportation machine. With but one interval of 9 months in 1918 and 1919 we had a car shortage throughout the whole of the years 1916-17-18-19 and 20. This shortage rose to as high as 160,000 cars with a corresponding shortage of motive power. We paid tremendous sums in commercial losses and unemployment in consequence. We laid it on to the war. We should lay it on to our lack of foresight and antagonism to railroads.

Railroad Expansion Needed for Prosperity

Few people seem to realize the amount of expansion in our transportation machine necessary to keep pace with the growth of the country. And an equal few seem to have any notion of the price we pay for not having it.

Our country is more dependent upon railway transport than any other. All others have comparatively greater coast lines and internal waterways.

The experience of the twenty years before the war has shown that we must build an extension of lines, including terminal facilities, additional sidings, etc., every year equal to the construction of a new railway from New York to San Francisco.

We must add at least 120,000 cars and 2,500 locomotives annually to our equipment. Since we entered the war in 1917 we have constructed at least 10,000 miles of railways less than our increasing population and economic development called for and we are behind in rolling stock by about 4,000 locomotives and 200,000 cars.

I wish to emphasize that unless we can have an immediate resumption of construction and equipment, our commercial community will pay treble the cost of the whole of them in their losses of a single season.

The very moment that we reach anything like normal business we shall see a repetition of car shortages, followed by an increase in the cost of coal to the consumer from one to three dollars a ton.

We shall again see premiums of 20 cents a bushel for the use of cars for moving grain.

We shall in fact see a shortage of commodities to the consumer; and we shall see gluts upon the hands of the producers.

We shall see factories filled with orders again closed for lack of cars; we shall see large intermittency in employment; and we shall see the usual profiteering in commodities due to a stricture between the producer and consumer.

There would be no difficulty whatever, by basing such losses on the experiences we have already had, to calculate a loss to the American people of a billion dollars for each one of these periodic transportation shortages.

II

No Loss So Great As That of Unemployment

FURTHERMORE, there is nothing that is so irrecoverable a loss to the nation as idle shops and idle men. To-day we have both. There is nothing that will so quickly start the springs of business and employment as an immediate resumption of construction and equipment of the railways.

When business does resume, we shall need all of our capacity for the production of consumable goods. We shall not only find it **STRANGLER FOR LACK OF TRANSPORTATION**, but we shall find ourselves plunging into the manufacture of this very railway equipment and construction in competition with consumable goods for materials and labor.

Herein lies the basic cause of destructive price inflation and booms, with all their waste and over-expansion. In times of depression, we should prepare for the future and by doing so we can cure the depression itself.

Why New Capital is Not Going Into Railroads

If we examine the fundamental reasons for failure to resume equipment, we will find them in the loss of confidence in railways as an investment and the competition of tax-free securities. We have passed the period of credit strain in this depression. Surplus capital is pouring by hundreds of millions monthly into tax free securities and foreign loans, and yet our railways are unable to finance the most moderate of construction programs.

The confidence of the public in railway investments

was at so low an ebb before the war that financing by the issue of common and preferred stocks had become impossible and railway expansion was living on bond issues.

The confidence of an assurance and continuity in earning power to cover this burden of bonds has been even lowered since the war began, because of the uncertainties of both rising and falling prices, of rising and falling wages, of rising and falling rates preventing all regularity of earnings upon which an investor could be convinced, even if no other difficult factors entered into the problem.

I see no occasion to go into the labyrinth of past railway finance, its propriety, or lack of propriety, its foolishness or its skill. **THAT GENERATION IS GONE BY.** This Commission approaches the financial problems of the railways upon the actual value, not upon their issues of securities and I take it we are living for the future, not the past. We want transportation, and we want it with the values of private initiative and clean public service.

If we look to the immediate future with its complete necessity of paring the railway earnings down to little more than bond interest, until we give relief to the shipper (and thus the primary foundation to business recovery) I can see little likelihood of convincing the investor as to his margins of safety. There is an atmosphere that our railways will never again earn profits, and that they are not as an industry worthy of investment, and that because private investors will not come to their assistance nobody can do anything.

Far from it being impossible for our railways again to return to a profitable footing, I believe it is possible to demonstrate that on an average they will become very profitable. If we assume that the reduction of prices and wage levels will settle at a plane no lower than 50 per

cent over pre-war, and if we assume that the present rates are to maintain, and if we assume restored traffic, then the earnings of our railways would exceed 15 per cent on the whole of the Commission's tentative valuation. Surely there is room here for safety to investment, as well as relief to the shipper.

But the circumstances being as they are, confidence being at a low ebb, we do not have the equipment necessary for our business. We are driving headlong for a setback to our whole commerce the very moment that we begin to get on our feet.

One Way to Start a Revival of Prosperity

In these circumstances it seems to me vital that the railways, as our greatest industry, should propose a courageous program of broad visioned betterments and if necessary the Government should consider giving the use of its superior credit. It would not cost the taxpayer a cent to give the Government guarantee to equipment trusts upon the primary responsibility of the railways the proceeds devoted entirely to improvement and equipment.

This is no proposal to take money from the taxpayer. It is a proposal to save him from paying treble the amount of his guarantee in profiteering and losses. It will render a reduction of rates earlier, for unless something is done the improvements will have to be paid over years out of increased rates.

Nor would we lose a cent upon the guarantee for if American railways cannot earn interest upon their borrowings let us throw up our hands and prepare for a second Russia.

A real program of construction would in its various ramifications give relief to five or six hundred thousand of our unemployed. It would enable even added numbers

to increase their standard of living, and thus give increased market to the produce of our farmers.

Our farmers who look to foreign markets for their surplus should stop to consider that our home consumption of meat decreased nearly 7 pounds per capita in 1921, mostly owing to unemployment and that if this decrease could be overcome it would be worth more than a 35 per cent increase in exports.

III

Money Spent on American Railroads Brings Prosperity to All Classes

WE talk glibly of giving billions of credits to foreign countries, to increase our farm exports. I wish to say with all responsibility for the statement, that a billion dollars spent upon American railways will give more employment to our people, more advance to our industry, more assistance to our farmers, than twice that sum expended outside the frontiers of the United States—and there will be greater security for the investor.

Finally, I want to refer to the veritable witches cauldron being fed constantly with hates distilled from the misdeeds of railway promoters in the past, from the conflicts between the railways and the farmers, between the railways and their workmen.

From all the confusion that arises from it we destroy our railways and destroy ourselves.

With this Commission on one hand assuring honesty in finance, justice to the shipper and the railway investor, with the Railway Labor Board assuring justice to workers and, above all, with a great spirit of public service in our generation of railway managers, it is time to call off the witches and take some vision of our national situation if we are to pull ourselves out of this depression.

Comparison of Present Wage and Price Levels With Those of 1913

Before entering upon the question of readjustment of rates, I wish to set out some factors in the present economic situation that bear upon the entire question.

The following table [of index numbers] shows a few commodities and service groups, compared to 1913 as 100:

Farm crops, at the farm.....	98
All animals, at the farm.....	92
Retail foodstuffs.....	150
Cotton, at the farm.....	136
Wool, at the farm.....	101
Retail clothing.....	213
Steel billets, Pittsburgh.....	113
Copper.....	86
Zinc.....	90
Pig iron, Pittsburgh.....	128
Bituminous coal, at the mine.....	160
(estimated 4 districts)	
Bituminous coal (retail various localities).....	198-220
Yellow Pine Lumber (at the mill).....	189
Douglas Fir Lumber (at the mill).....	125
Lumber (retail) partly estimated.....	200
Cost of Living, variously estimated from.....	162-180
Wage Scales (approximate)	
(a) Farm Labor.....	135
(b) Textile industries.....	210
(c) Steel industries.....	150
(d) Railways.....	200
(e) Metal trades.....	218
(f) Building trades.....	190
(g) Coal Mining Scales.....	173

This table at once demonstrates:

- (1) The inequality in prices and wages between different groups of commodities.
- (2) The great increase in spread between "producer's" and "consumer's" goods.
- (3) The lag in wage scales.

The Real Cause of Business Depression

As the population engaged in the "deflated" producer's goods—agriculture, and metals, wood, etc.—comprises one-half the total in number of the nation, their power

to buy the same ratio of consumer's goods has been reduced to less than 70 per cent of pre-war, and is the consequent cause of a large part of the industrial and commercial unemployment and stagnation in our cities and our transportation.

I wish to especially call your attention to the indicated enormous increase in "spread" between primary producer's and ultimate consumer's goods. In considering it, we must bear in mind that when we use 100 for both consumer's and producer's goods of 1913, we have already included the spread between producer and consumer at that period. I therefore believe that the index numbers indicate an increase of 100 per cent in the actual spread.

It is right here where the most of our economic difficulties lie today.

Our increased cost of manufacture and distribution bears two relations to the rate question—first, that the increases of rates of from 30 per cent to 100 per cent in different commodities are part of it, and are in turn partly caused by it; and second, the increased rates bear very unequally on different groups in the community.

If we search for the cause of this increase of spread we shall find therein a vast complex of increased taxation, increased wages, rents, and a dozen items, all reacting upon each other, and also expressing themselves in increased cost of operating the railways.

For instance, the total increase in national, state and municipal taxes since 1913 is approximately \$5,640,000,000.

At the present purchasing power of the dollar, our total national productivity is probably somewhere around 50 billions of dollars, of which over 10 per cent must now be devoted to increased taxes. This sum of money must be obtained either from the producer or the consumer and in any event a considerable part of the taxes contributes to widen the spread.

Because the increase in spread due to taxes necessitates a spiral of increased wages, rents, etc., and before its force expends itself, my own opinion is that possibly 20 points in the distorted index numbers flow from increased taxes.

The increase of railway rates since 1913 for Class I railways, is about \$2,600,000,000, of which about \$1,400,000,000 are due to wage increases and about \$160,000,000 to tax increases. If our traffic were normal the total increase of rates would be more like \$3,500,000,000. These sums enter into this increase in the spread and carry with them a further trail of increased living costs and again a spiral of higher wages, rents, etc., in all other branches of manufacture and distribution.

There are other causes of the increased spread, some of which will be mitigated with time.

No one can say to what particular table-land of prices and wages we may settle upon, but it is a certainty that the exchange value of producer's goods will not again line up with consumer's goods unless we can decrease the costs and eliminate the waste of our whole manufacturing and distribution trades. And unless we can secure their nearer proximity we shall retard a return of employment and prosperity.

The Real Cure, Abolishing the Causes of the "Spread"

I wish to digress for just a moment from railway to agricultural subjects, to point out that the recent projects for fixing farm prices by law are apparently founded on the notion that by raising agricultural prices up to the levels of consumer's goods we can remedy the extreme hardship of our farmers.

Even if it were possible to raise the prices, much less advantage would accrue to the farmer than anticipated. Unless the "spread" is decreased by actual savings, the

costs of manufacture and distribution would be at least partially increased by higher prices of producer's goods.

The spread is fundamentally due to increased cost of manufacture and distribution, not to the fall in producer's goods. The real remedy is an attack upon the causes of the spread and thereby to bring consumer's goods down to the producer's buying power.

It is a certainty that in order to decrease the spread, railway rates must come down and for rates to come down costs of railway operation in wages and prices of supplies must be reduced. Until this adjustment is secured the economic machine will continue to move slowly.

We cannot and should not expect wages to come back to pre-war levels. Many of our wage scales were too low in pre-war times. They can follow down step by step with the cost of living, but there are permanent charges in this spread, such as the taxes, which will hold the cost of living above pre-war levels. We must gain our other reductions in the spread by increased national efficiency.

IV

A Method of Readjusting Rates

THE involved complex of transportation rates was obviously originally based on some relationship to the value of commodities, mitigated by competition. In other words, the old slogan of "what the traffic will bear" had some economic background. But this entire conception of ratemaking was destroyed by horizontal raises. We have rates clearly beyond what the traffic can bear.

The increases in railway rates during the past five years have fallen with extraordinary inequality on different commodities and different groups of people in the community. The country grew up, its industries were distributed under ratios of costs between different commodities, ratios between raw materials and finished goods, ratios between the farm and city.

These have all been distorted by the horizontal rises. The increases in rates since 1914, for instance, have added probably less than 1 per cent to the price of cotton goods on the average haul but it has added probably 60 per cent to the price of coal. The increased rates since 1914 have added nearly 100 per cent to the cost of assembling the materials for pig iron.

All this is artificially forcing our industries to move toward their raw materials. This does not alone represent the starting of a new factory; it is a movement of the whole mechanism of the community, labor, homes, schools, railways and what not—an enormous duplication of plant and loss of capital. We shall ultimately have the rates readjusted and then we shall destroy the new industries created under it.

Of equal importance—there is a new economic light on

this distortion of rates evident under the stress of the last few years. That is, the better realization that some increases of rates come mostly off the producer while others are paid by the consumer. Increases in spread between producer and consumer do not fall equally upon each of them.

In primary commodities, where the price is fixed by international competition, the increase or decrease in rates is a deduction from the producer. Take wheat, for instance, the point of competition with foreign produce lies at Liverpool. The net to the producer is Liverpool less transportation and other handling charges. Therefore increases of rates are a deduction from the farmers' price.

The same thing applies to the producer in certain cases of domestic competition. Also where there is rapid turnover, as in manufacture, and consequent ability to reduce supply, the consumer pays the freight, as processes of productivity will not continue below profit point. In most manufactured commodities the consumer pays the freight, for production quickly shrinks when prices at the factory become unprofitable and the price to the buyer is the factory price plus the freight. For instance, in hides, the farmer gets the international price less freight. On boots he pays the manufacturer's cost, profit and freight.

It appears to me that with the paralysis induced by the increased spread, we have to take a broader vision of what part of the community is suffering most and direct such concessions through the railway rates as can be given to that group—if we would better equalize the whole economic lead.

The Average Freight Rate Must be Maintained

During the past eight months, the railways have made many thousand readjustments of local rates in endeavoring to heal local distortions, but I am convinced that the whole railway rate structure needs a most systematic overhaul in the light of these new economic forces that have been brought into play.

Obviously we must maintain the average rate that will support our transportation systems adequately and such an overhauling of rates might quite well mean the *advancement* of rates in certain commodities in order that compensation can be given to others where there is undue duress.

If I were to discuss the rates charged today I should say at once that a decrease in passenger rates is not nearly so vital to the community as freight rates, for passenger rates do not enter into the "spread" in proportion to the relative volume of earnings. If I were examining the freight rates I should at once say that coal, metals, wood, and agricultural and other producers goods should be reduced to the bottom before less than carload lots (L. C. L.) and class rates are touched.

I would be willing to go even farther and say that I am convinced that even if the Commission cannot at the present moment justifiably reduce railway incomes a single dollar, it is warranted in investigating the possibility of some relief to the more distressed commodities by a revision of some rates upward. There is perhaps no great field for changes in this direction but it is worth inquiry. As mentioned above an economic analysis of our industry will show that less than carload lots and class rates are far too low compared to the rates on primary commodities.

With the gradual return of the traffic to normal, with

decreased operating costs, relief in rates will be available, and *it would be an economic crime to apply such relief by horizontal reductions to all rates* thus giving relief to higher priced goods and travel, when the vital mainspring of our economic life, our agriculture and fuel and metals are choked.

V

The Present Rate Situation

DETERMINATION of anything in the nature of permanent rate basis is in my own view impossible at the present time because:

The last five years of changing administration, irregular traffic and wildly fluctuating wages and prices of materials give us but little reliable historical criteria upon which to base the future. We are in the midst of violent economic readjustments, of a profound industrial depression. No one can determine to what plane the reduction in operating costs will settle. No one can estimate the volume of traffics that are probable for any particular period ahead.

It appears to me, therefore, that the Commission will need to temporize with the situation for some time, and that its conclusions may well fall into three periods:

1st—The immediate present.

2nd—During the early period of decreasing costs and increasing efficiency and slowly recovering traffics.

3rd—Normal operations.

THE IMMEDIATE PRESENT:

If we survey the results of the past year in the application of present costs and rates, we find many railways failing to earn interest upon their borrowed capital. We find some others, more fortunately situated, who have earned dividends on their share capital. One or two exceptions of low bonded indebtedness have done extraordinarily well on their share capital.

If we survey the situation by districts, in order that

single instances do not mislead us, we shall find that the whole of the Class I, Southern Roads, barely covered bond interest, while the most fortunate group, the Western Roads, show an earning of only 4 per cent in 1921 upon their tentative valuation. Moreover, it is obvious that maintenance has been held to a low level and new equipment and extensions practically *nil*.

The present (railroad) earnings, in their perilous closeness to bond obligations, seem to me to dispose of the question of immediate important rate relief, if we do not wish widespread receivership and shocks to our whole commercial fabric.

I believe there are cases where earnings could be increased by lower rates. I know that it is contended that such opportunities do not exist, but no one can review the testimony given here during the past few weeks without concluding that the rates in special instances are stifling business. These directions are perhaps not important in the whole problem of rates, but I am convinced that lower rates would recover lost traffic, such as export coal, substitutions in building materials, gains in water competition, etc.

THE SECOND PERIOD: DURING 1922.

We must assume that those railway wages and supplies which are out of line will at least in part follow down to the levels of decreased cost of living; we must assume that the efficiency that is slowly emerging after the Government management will still further increase; we must assume that the volume of traffics will increase toward normal.

I have the feeling that the railways, being our greatest business, will agree that all these savings should be instantly devoted to relief in the rates on primary commodities in order that we should expedite the recovery

that can only come through decreased spread between producer's and consumer's goods.

I recognize that the uncertainty and slow reduction of rates in this fashion will itself delay business recovery because of the uncertainty of business as to its future costs.

If our railways were in position to stand the temporary shock it would be infinitely better to drop the rates on primary commodities tomorrow—our business recovery would come faster. But we cannot ask the impossible.

THIRD: If we look further to normal times, we could make a rough calculation that present wages and costs at say 50 per cent above pre-war would show that the railways can earn somewhere around a billion five hundred million dollars, in excess of the 6 per cent minimum upon tentative valuation. As I have stated, relief is first more critically needed in the rates on primary commodities.

Some estimates given to me indicate that approximately 35 or 40 per cent of revenues are involved in the groups more urgently needing relief. I think it will also bear calculation that in the income assumed above that primary commodities can eventually be reduced to pre-war rates, and still place earnings upon a basis that will inspire such confidence in investors as will secure the free flow of investment capital into construction.

It is not to be expected that capital for these purposes will be available at the rate that does not exceed the tax-free securities at least 2 per cent to 3 per cent.

VI

The Efficiency of American Railways

A GREAT deal has been said about the inefficiency of our railway system. I do not sympathize with these statements. Comparison with foreign railways of the fundamental criteria of per ton mile costs, train loading and so forth, in the light of our cost of living, will demonstrate that our railways are of higher standards, better in methods than others and are growing in efficiency.

The consolidation of our railways into larger systems has been contemplated in our legislatures for some years past as a gain in efficiency. Its value can be over-estimated—it is not a panacea for all trouble. It does give hope, however, of economies in further efficiency from more complete utilization of rolling stocks and terminals, some small degree of saving in overhead, saving in current inventories, but its probably great saving would be the decreased cost of proper finance, increased financial stability and fuller independence from the supply companies.

It is probably unnecessary to refer to the question of Government ownership. No one with a week's observation of government railways abroad, or with government operation of industry in the United States, will contend that our railways could ever be operated as intelligently or as efficiently by the Government as through the initiative of private individuals. Moreover, the welfare of its multitude of workers will be far worse under Government operation.

We are struggling with the great problem of maintaining public control of monopoly, at the same time maintaining the initiative of private enterprise. I believe that we are steadily progressing to solution.

Great social and economic problems find their solution slowly and by a process of trial and error. We have tried unregulated monopoly, and have tried Government operation, and found the error in them. We still have much to solve if we are to maintain our transportation. Much of this solution depends upon the successful initiative of the railways themselves and much of the shaping of these matters lies fortunately in your able hands.

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